2. Foreign Market-Derived Confidential Information

a. Competing U.S. Carrier Information

171. We proposed in the *Notice* to adopt a No Special Concessions ban on a U.S. carrier's exclusive receipt of proprietary or confidential information obtained by a foreign carrier with market power in the course of its dealings with another U.S. carrier, unless specific permission had been obtained in writing from that U.S. carrier.[335] If this ban were adopted as part of the No Special Concessions rule, however, U.S. carriers could accept the confidential information of a competing U.S. carrier, provided the foreign carrier either lacked market power or made the information available to all similarly situated carriers on the U.S. end.[336] As a result, we find that preserving the confidentiality of competing U.S. carriers' information requires that we prohibit U.S. carriers from receiving such information from any foreign carrier absent permission, without regard to that foreign carrier's ability to exercise market power and without a provision allowing for non-discriminatory dissemination. We find that this general approach is consistent with our general policy governing the confidentiality of competing carrier information.[337] We thus prohibit U.S. carriers from receiving proprietary or confidential information obtained by *any* foreign carrier in the course of its regular business dealings with a competing U.S. carrier, unless the competing U.S. carrier provides its specific permission in writing. We clarify that, where a U.S. carrier is affiliated with a foreign carrier, the proprietary or confidential information of other U.S. carriers obtained by that foreign affiliate may not be used for any purpose other than for conducting the correspondent relationships with those U.S. carriers from which it obtained the information. We adopt this rule as a general requirement on all existing, pending, and future authorizations to provide U.S. international services.[338]

b. U.S. Customer Proprietary Network Information

172. We requested comment in the *Notice*[339] on whether a U.S. carrier's use of foreign market telephone customer information is subject to Section 222 of the Act and any rules that the Commission adopts to implement that provision.[340] In enacting Section 222, entitled "Privacy of Customer Information," Congress expressly directed a balancing of "both competitive and consumer privacy

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[335] *See Notice* ¶ 117.

[336] *See* 47 C.F.R. § 63.14.

[337] *Cf.* 47 U.S.C. § 222(a) (imposing a duty on "[e]very telecommunications carrier . . . to protect the confidential or proprietary information of, and relating to, other telecommunications carriers . . .").

[338] *See infra* Appendix C (to be codified at 47 C.F.R. § 63.21(f)).

[339] *See Notice* ¶ 106.

[340] *See* 47 U.S.C. § 222; *see also Implementation of the Telecommunications Act of 1996: Carriers' Use of Customer Proprietary Network Information and Other Customer Information*, CC Docket No. 96-115, Notice of Proposed Rulemaking, 11 FCC Rcd 12,513 (1996) (*CPNI Notice*).

interests" with respect to customer proprietary network information (CPNI).[341] We examine foreign market telephone customer information in light of Section 222.

173. Several commenters oppose applying Section 222 to the use of foreign-derived CPNI. Sprint and SBC assert that foreign-derived customer information is not CPNI under Section 222.[342] Sprint argues that the Commission is not responsible for the privacy of such information, which pertains to foreign citizens and is within the jurisdiction of a foreign administration. To the extent the United States has any interest, Sprint claims, it relates solely to the possibility that unequal distribution of such information will harm competition in the United States.[343] AT&T asserts that a U.S. carrier's exclusive use of customer information derived from its foreign affiliate is within the Commission's authority.[344] SBC contends that applying Section 222 "would raise numerous foreign relations problems."[345]

174. USTA contends that rules governing foreign-derived CPNI are not necessary but argues that, if the Commission decides to move forward, "[i]t is absolutely vital that these rules be consistent with the domestic CPNI rules now under consideration."[346] USTA also asserts that the Commission should avoid imposing "onerous" customer approval procedures that would make it harder to provide one-stop shopping options or to notify customers of new products.[347] Sprint argues in favor of a case-by-case approach that would allow the Commission to ban the use of foreign market information where such information could have an anticompetitive effect on a particular route.[348] AT&T concludes that it is unclear whether Section 222 applies to a foreign carrier's foreign market telephone customer information, but asserts that the Commission has the authority to require a U.S. affiliate to make

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[341] *See* Joint Statement of Managers, S. Conf. Rep. No. 104-230, at 205 (1996). The Act defines CPNI as "information that relates to the quantity, technical configuration, type, destination, and amount of use of a telecommunications service subscribed to by any customer of a telecommunications carrier, and that is made available to the carrier by the customer solely by virtue of the carrier-customer relationship; and information contained in the bills pertaining to telephone exchange service or telephone toll service received by a customer of a carrier." 47 U.S.C. § 222(f)(1).

[342] *See* Sprint Comments at 24; SBC Comments at 5.

[343] *See* Sprint Comments at 24-25.

[344] *See* AT&T Reply Comments at 35 n.58.

[345] SBC Comments at 5-6.

[346] USTA Comments at 6; *see also* USTA Reply Comments at 5.

[347] USTA Comments at 6.

[348] *See* Sprint Comments at 25-26.

available on a nondiscriminatory basis any foreign market telephone customer information it obtains from its foreign affiliate.[349]

175. We have issued a notice of proposed rulemaking to establish rules governing carrier use of CPNI pursuant to Section 222.[350] Our proposed rules, however, do not address the use of U.S. customer information derived from a foreign telecommunications market. We recognize here that *foreign customer* information derived from a foreign network is within the jurisdiction of foreign administrations, but we note that foreign carriers also may collect information about *U.S. customers* who either make international calls to, or receive calls from, the foreign country. We consider this U.S. customer information to be foreign-derived CPNI.[351] Absent effective safeguards, a U.S. carrier could acquire from a foreign carrier, and make use of, this information without obtaining the U.S. customer's consent. Use of this information raises concerns about U.S. customer privacy. We also find that the use of foreign-derived CPNI in the U.S. market could raise competitive concerns, as Sprint contends.[352] In particular, competition in the U.S. market might be harmed if a U.S. carrier were to gain exclusive access to CPNI generated by a foreign carrier through its monopoly control or near-monopoly control in a relevant market on the foreign end of a particular route. Rival U.S. carriers would have no alternative means to obtain similar information on that route. We conclude here that safeguards are necessary given the privacy concerns and anticompetitive effects that may result from the use of foreign-derived U.S. customer CPNI.

176. Section 222(a), by its terms, applies a duty on *every* telecommunications carrier to protect the confidentiality of customer information.[353] We find that this general obligation requires all U.S. carriers to protect individual U.S. customers' information, whether the information is U.S.- or foreign-derived. We are not persuaded that a case-by-case approach to banning the use of foreign-derived CPNI, as Sprint suggests, would address our concerns related to U.S. customer privacy. In response to the comments of USTA, we adopt rules governing foreign-derived U.S. customer CPNI

[349] *See* AT&T Comments at 49 n.80; AT&T Reply Comments at 35 n.58.

[350] *See CPNI Notice*, 11 FCC Rcd 12,513.

[351] As noted above, the Act defines CPNI as information made available to the carrier by the customer by virtue of the carrier-customer relationship. *See* 47 U.S.C. § 222(f)(1). If a U.S. carrier collects information pertaining to a customer on the U.S. end, it would be subject to the rules to be enacted in our proceeding implementing Section 222(c) of the Act. *See CPNI Notice*, 11 FCC Rcd 12,513. Although a foreign carrier generally does not have a direct relationship with U.S. customers, it may have the ability to collect this information as it originates or terminates traffic to or from U.S. customers. If a foreign carrier collects this U.S. customer information on the foreign end of a U.S. international route, we consider this information to be foreign-derived CPNI.

[352] *See* Sprint Comments at 25-26.

[353] *See* 47 U.S.C. § 222(a).

that are consistent with Section 222 of the Act.[354] We therefore conclude that if a U.S. carrier desires to gain access to, or make use of, foreign-derived CPNI pertaining to a specific U.S. customer, it must first obtain approval from that customer.[355] In doing so, the U.S. carrier also must notify the customer that the customer may require the U.S. carrier to disclose the CPNI to unaffiliated third parties upon written request by the customer.[356] This requirement serves to alert the customer of its right to decide whether, in addition to the requesting carrier, it would like other carriers to gain access to the information. Taken together, these procedures balance Section 222's privacy and competitive issues. We find, moreover, that these conditions are not unnecessarily burdensome and will not prevent U.S. carriers from offering one-stop shopping options.

C. Competitive Safeguards for Affiliated Carriers

177. As we noted above, a U.S. carrier and a foreign carrier with market power on the foreign end of a particular route may have the ability, absent effective safeguards, to engage in anticompetitive behavior that results in competitive harms in the U.S. market.[357] Consistent with our previous decisions,[358] we find that an ownership affiliation between a U.S. carrier and its foreign counterpart significantly increases the ability and often the incentive to engage in such behavior. Anticompetitive strategies are easier to enact when carriers share common ownership; the incentive to do so, moreover, is frequently much greater when the profits from such behavior accrue to an affiliated or integrated entity. As we stated in the *Foreign Carrier Entry Order*, a foreign carrier can benefit directly by engaging in anticompetitive behavior that increases the profits of its U.S. affiliate when the

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[354] *See* USTA Comments at 6; USTA Reply Comments at 5.

[355] We emphasize that the U.S. carrier may not use foreign-derived CPNI to select which U.S. customers it will seek approval from. Additionally, we clarify that where a U.S. carrier is affiliated with a foreign carrier that collects foreign-derived CPNI, the U.S. carrier may not permit access to, or make use of, the information for any prohibited use.

[356] This approach is consistent with Section 222(c). *Cf.* 47 U.S.C. § 222(c)(1) (providing that a carrier can use CPNI only in the provision of the telecommunications service from which it was derived, except with the approval of the customer or as required by law); *id.* § 222(c)(2) (requiring a carrier to disclose CPNI to any person designated by the customer, upon written request by the customer). We recognize that Section 222(c)(1)(A) permits a carrier's use of CPNI "that [it] receives or obtains . . . by virtue of its provision of a telecommunications service," *see id.* § 222(c)(1)(A), whereas in the scenarios discussed in the text above, a U.S. carrier does not acquire the U.S. customer CPNI "by virtue of its provision of a telecommunications service," but rather from a foreign carrier. Nonetheless, customer approval for use of foreign-derived U.S. customer CPNI satisfies the carrier's duty to protect the confidentiality of customer information.

[357] *See supra* Section V.A.

[358] *See Foreign Carrier Entry Order*, 11 FCC Rcd at 3902-03 ¶ 79; *see also International Services Order*, 7 FCC Rcd at 7332 ¶ 10.

profits are passed through to the foreign carrier.[359] Similarly, a significant investment in a U.S. carrier can provide a foreign carrier with sufficient influence to entice the U.S. affiliate to engage in anticompetitive conduct in the U.S. market.

178. Because we find that affiliated carriers have a "heightened" ability and incentive to engage in anticompetitive behavior, we therefore apply additional safeguards to U.S. carriers on routes where they are affiliated with foreign carriers. We clarify that our decision here retains the "greater than 25 percent" ownership affiliation standard that we adopted in the *Foreign Carrier Entry Order*.[360]

1. Benchmark Conditions

Background

179. In the *Notice*, we observed that we had proposed in our *Benchmarks* proceeding to condition the facilities-based switched and private line authorizations of U.S. carriers to serve affiliated foreign markets on the affiliated foreign carrier offering U.S. carriers a settlement rate that is at or below the relevant settlement rate benchmark.[361] Following the release of our *Notice* we adopted the *Benchmarks Order*, which prohibits a U.S. carrier from offering facilities-based switched or private line service to an affiliated market unless its foreign affiliate charges a settlement rate to all U.S. carriers that does not exceed the relevant benchmark.[362] We concluded that this benchmark condition would reduce the ability of a U.S. facilities-based carrier to execute a "predatory price squeeze."

180. In an *Ex Parte* filed in the *Benchmarks* proceeding, AT&T argued that we should apply the facilities-based benchmark condition we proposed in the *Benchmarks Notice* to authorizations to provide switched resale service from the United States to an affiliated market.[363] AT&T attached to its *Ex Parte* its comments in this proceeding. We concluded in the *Benchmarks Order* that AT&T's

[359] *See Foreign Carrier Entry Order*, 11 FCC Rcd at 3902-03 ¶ 79.

[360] *See Foreign Carrier Entry Order*, 11 FCC Rcd at 3967-68 ¶ 249. For purposes of determining a U.S carrier's regulatory treatment, we generally consider a U.S. carrier to be affiliated with a foreign carrier if a greater than 25 percent interest, or a controlling interest at any level, is held by a foreign carrier, or if the U.S. carrier holds an interest of more than 25 percent in, or controls, a foreign carrier. 47 C.F.R. § 63.18(h)(1)(i). As we stated in the *Foreign Carrier Entry Order*, we also may find that a U.S. carrier should be treated as an affiliate of a foreign carrier where there is a significant potential impact on competition, even if the investment falls below the 25 percent affiliation threshold. *See Foreign Carrier Entry Order*, 11 FCC Rcd at 3906 ¶ 89, 3968 ¶ 250.

[361] *See Notice* ¶ 119 (citing *International Settlement Rates*, IB Docket No. 96-261, Notice of Proposed Rulemaking, FCC 96-484 (rel. Dec. 19, 1996)).

[362] *See Benchmarks Order* ¶¶ 195-231.

[363] Letter from James Talbot, AT&T, to William Caton, Acting Secretary, Federal Communications Commission, IB Docket No. 96-261 (July 10, 1997).

argument was better addressed in this proceeding, where we would have a more complete record on the issue of applying the benchmark condition to switched resale service.[364]

Positions of the Parties

181. Commenters for the most part raise the same arguments in this proceeding as they raised in our *Benchmarks* proceeding. As in the *Benchmarks* proceeding, some commenters support our settlement rate benchmark condition for authorizations to provide international facilities-based service from the United States to an affiliated foreign market, some oppose it on the ground that it is not necessary, and others seek to modify the condition because, they argue, it is not stringent enough. Some commenters also raise concerns, as they did in the *Benchmarks* proceeding, that the condition violates the United States' GATS obligations.

182. Certain commenters state that the benchmark condition is not necessary because foreign-affiliated carriers do not have the ability and/or incentive to execute a price squeeze.[365] Others contend that a benchmark condition is not necessary because market forces will force significant reductions in settlement rates without further regulatory intervention.[366] Some commenters argue that there are means to address potential anticompetitive behavior other than the benchmark condition.[367]

183. Several commenters also express a concern that the benchmark condition violates the United States' GATS obligations. Some contend that the condition constitutes a prohibited pre-entry restriction and will create a barrier to entry into the U.S. market.[368] Others argue that the condition is

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[364] *Benchmarks Order* ¶ 230.

[365] Telefónica Internacional Comments at 7; Cable and Wireless Reply Comments at 4-6.

[366] *See, e.g.*, Telefónica Internacional Comments at 11; GTE Reply Comments at 24 (citing our *Foreign Carrier Entry Order* as support for the argument that competitive pressures and Commission policies have strengthened the ability of U.S. carriers to negotiate lower accounting rates); GTE Reply Comments at 20-21 (concerns about price squeeze are rooted in a static view of the world and ignore the fact that competitive pressures are increasing); Cable and Wireless Reply Comments at 6 (implementation of the WTO Basic Telecom Agreement will give U.S. carriers the right to enter foreign markets and provide end-to-end service in direct response to any anticompetitive conduct); *see also* TAS Comments at 2 (arguing that the benchmarks condition is inappropriate in light of multilateral reform efforts and that, because the benchmarks are themselves inappropriate, the benchmark condition is inappropriate).

[367] *See, e.g.*, GTE Reply Comments at 22-23 (arguing that our *Access Charge Reform Order* supports its argument that existing Commission reporting requirements and U.S. antitrust laws are sufficient to detect and address price squeeze behavior); Telstra Reply Comments at 10.

[368] *See, e.g.*, KDD Comments at 10; France Telecom Comments at 22-23; Japan Comments at 3; Viatel Comments at 7-8; Telstra Reply Comments at 9; Telefónica Internacional Comments at 12-13; Cable and Wireless Reply Comments at 7-8.

inconsistent with the national treatment and/or Most Favored Nation ("MFN") principles of the GATS because, they argue, it is directed at foreign carriers.[369]

184. AT&T supports using the settlement rate benchmarks as an authorization condition to address price squeeze behavior by carriers serving affiliated markets.[370] However, AT&T contends that we should condition a carrier's authorization to serve an affiliated market on that carrier's foreign affiliate offering U.S. carriers a cost-based settlement rate, rather than a settlement rate at or below the relevant benchmark.[371] AT&T further argues that we should apply the same condition we proposed in the *Benchmarks Notice* for authorizations to provide facilities-based switched service from the United States to an affiliated market to authorizations to provide switched resale service from the United States to an affiliated market. AT&T submits an affidavit of William Lehr which argues that the same ability and incentives to engage in a price squeeze that exist with respect to facilities-based service to affiliated markets apply with equal force to the provision of switched resale to affiliated markets.[372] According to AT&T, because resale entry has major advantages over facilities-based entry, application of the benchmark condition to the provision of switched resale services to affiliated markets is especially imperative.[373]

185. AT&T further argues that the benchmarks condition is necessary to address the incentive of foreign-affiliated facilities-based carriers and switched resellers to distort traffic flows from the U.S. market. Specifically, AT&T argues that a foreign-affiliated carrier providing service in the U.S. market could distort traffic flows in two primary ways: (i) by participating in a call turnaround scheme to turn the U.S.-inbound calls of its foreign affiliate into U.S.-outbound calls; and (ii) by re-originating from the United States calls from a third country.[374] AT&T states that these traffic distortion schemes would harm consumers by increasing U.S. net settlement payments. This increase would, according to

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369 *See, e.g.*, KDD Comments at 10; Viatel Reply Comments at 9; GTE Reply Comments at 21; Sprint Comments at 29; Telefónica Internacional Comments at 29.

370 AT&T Comments at 24-30.

371 *Id.*; *see also* MCI Comments at 3; Letter from Sanford C. Reback, Larry A. Blosser, Scott A. Shefferman to Magalie Roman Salas, Secretary, FCC, IB Docket No. 97-142 (November 17, 1997) at 2 (MCI November 17 *Ex Parte*) (arguing that the benchmark condition should apply to the switched resale authorization of any carrier whose foreign affiliate carries more than 25 percent of the traffic on the route between its home country and the United States, or where there is control of bottleneck facilities or services on either end of the route).

372 AT&T Comments, Attachment 3: Affidavit of William H. Lehr on Behalf of AT&T Corp. ("Lehr Affidavit").

373 AT&T Comments at 32; Lehr Affidavit at 16-18.

374 AT&T October 27 *Ex Parte* at 18-20.

AT&T, increase U.S. carriers' marginal costs. which in turn would put upward pressure on calling prices.[375]

186. AT&T proposes that if the Commission does not apply the benchmarks condition for service to affiliated markets adopted in the *Benchmarks Order* to switched resellers, the Commission should "require the foreign affiliate to charge usual (i.e., benchmark glidepath) settlement rates for its existing traffic, *and* the "best practice" settlement rate for incremental minutes (i.e., minutes above levels consistent with the existing industry outbound-inbound traffic ratio)."[376] AT&T states that this condition would reduce but not eliminate a foreign-affiliated carriers' incentives to engage in settlement manipulation activities. WorldCom and MCI make similar proposals. WorldCom argues that the Commission should condition authorizations to provide switched resale service to an affiliated market on the switched reseller's foreign affiliate "(1) committing to abide by the transition schedules and proportional glide-path requirements set forth in the FCC's *Benchmarks Order*; and (2) within 90 days of the grant of authority, entering into unconditional commercial agreements complying with the *Benchmarks Order*."[377] MCI similarly proposes that the Commission condition switched resale authorizations on the foreign carrier entering into a binding contractual commitment with U.S. carriers that it will reduce its settlement rate to the applicable benchmarks by the date established in the *Benchmarks Order* and make a binding commitment to undertake proportionate annual reductions in its settlement rates.[378] WorldCom states that its proposal recognizes the distinction between the potential for market distortion by facilities-based and switched resale entry.[379] WorldCom and MCI also state that allowing foreign carriers to enter the U.S. market without making a commitment to comply with the settlement rate benchmarks would undermine the *Benchmarks Order* by creating a disincentive for foreign carriers to negotiate lower accounting rates.[380]

187. Cable and Wireless opposes AT&T's request that we extend the benchmarks condition to the provision of switched resale services. Cable and Wireless states that the condition is not necessary, as evidenced by the fact that it and other carriers have been providing switched resale

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[375] Letter from Judy Simonson to Magalie Roman Salas, Secretary, FCC, IB Docket No. 97-142, FCC File No. ITC 97-127 (November 18, 1997) at 10-11 (AT&T November 18 *Ex Parte*).

[376] *Id.* at 2.

[377] Letter from Robert S. Koppel to Magalie Roman Salas, Secretary, FCC, IB Docket No. 97-142 November 18, 1997) (WorldCom November 18 *Ex Parte*).

[378] Letter from Sanford C. Reback, Larry A. Blosser, Scott A. Shefferman to Magalie Roman Salas, Secretary, FCC, IB Docket No. 97-142 (November 18, 1997) at 1 (MCI November 18 *Ex Parte*).

[379] WorldCom November 18 *Ex Parte*.

[380] *Id.*; MCI November 17 *Ex Parte* at 1.

services for years without evidence of price squeeze behavior.[381] AT&T dismisses this argument, countering that Cable and Wireless' regulation as a dominant carrier and its position as one of a few U.S.-licensed carriers with a foreign affiliate made it unlikely to attempt to engage in anticompetitive behavior.[382]

188. Cable and Wireless further states that extending the condition would undermine competition in the U.S. market by preventing future competitors from providing service and forcing existing competitors to cease providing service.[383] Such a result, Cable and Wireless argues, would undermine competition in the U.S. IMTS market and be disruptive to customers of existing carriers.[384] It cites its own operations as an example of the potential impact of extending the condition to switched resale services. It states that if the condition is applied to switched resale services, Cable and Wireless would effectively be forced to discontinue service to several countries, which would have a severe financial impact on the company.[385] AT&T disputes this claim. It contends that Cable and Wireless is essentially arguing that, unless Cable and Wireless' foreign affiliates can continue to receive above-cost settlement payments from U.S. carriers, Cable and Wireless cannot continue to provide service to affiliated markets.[386] AT&T concludes that this cannot be true, given that Cable and Wireless is "a highly profitable corporation."[387]

189. Cable and Wireless further argues that there are several differences between the facilities-based and switched resale markets that make application of the condition to switched resale

[381] Letter from Robert J. Aamoth and Joan M. Griffen to William Caton, Acting Secretary, FCC, IB Docket No. 97-142 (October 10, 1997) at 1-2 (Cable and Wireless October 10 *Ex Parte*); *see also* Letter from Alfred M. Mamlet and Colleen A. Sechrest to William Caton, Acting Secretary, FCC, IB Docket No. 97-142 (October 28, 1997) at 2-3 (Telefónica Internacional October 28 *Ex Parte*); Letter from Hance Haney to William F. Caton, Acting Secretary, FCC, IB Docket 97-142 (November 14, 1997) at 2 (USTA November 14 *Ex Parte*).

[382] Letter from Kristen Thatcher to William Caton, Acting Secretary, FCC, IB Docket No. 97-142 (October 27, 1997) at 16 (AT&T October 27 *Ex Parte*).

[383] Cable and Wireless October 10 *Ex Parte* at 2-4; *see also* USTA November 14 *Ex Parte* at 1. Cable and Wireless also contends that the Commission lacks adequate notice to apply the condition to existing Section 214 resale authorizations. Cable and Wireless October 10 *Ex Parte* at 20.

[384] *Id.* at 4-5; *see also* Telefónica Internacional October 28 *Ex Parte* at 5-6.

[385] *Id.* at 4. Cable and Wireless states that it serves nearly 80,000 customers in the United States, 50% of which made at least one call to a Cable and Wireless-affiliated country in the last three months.

[386] AT&T October 27 *Ex Parte* at 15.

[387] *Id.*

services unnecessary or undesirable.[388] First, it contends that the competitive impact of applying the condition would be much greater for switched resale services. Second, it claims that it would be easier to detect a price squeeze strategy in the switched resale context because the Commission and underlying facilities-based carriers know, or can easily ascertain, the wholesale rates that the switched resale carrier pays to the underlying facilities-based carrier.[389] AT&T and MCI disagree, arguing that there are certain factors that make monitoring of wholesale prices difficult.[390] Third, Cable and Wireless states that a switched reseller has less incentive to engage in a below-cost pricing scheme because it is less likely such a scheme would be profitable. The reasons for this, according to Cable and Wireless, are that a resale carrier normally will have higher costs and lower margins than a facilities-based carrier serving the same route and, unlike a facilities-based carrier, a resale carrier does not qualify for return traffic from its foreign affiliate.[391] Finally, it states that a below-cost pricing strategy would cause the underlying facilities-based carrier to raise the wholesale rates it charges to the resale carrier because increased traffic from the resale carrier would increase the net settlement payments of the underlying facilities-based carrier. This would in turn raise the costs of the switched reseller as it gains market share from its below-cost pricing.[392] AT&T, on the other hand, contends that, because of the intensity of wholesale competition among facilities-based carriers, the reseller's facilities-based carrier is unlikely to raise wholesale prices.[393] AT&T further argues that even if a reseller's wholesale prices did increase, the increase might be offset by return traffic to the switched reseller's foreign affiliate.[394]

190. Cable and Wireless also disputes the Lehr Affidavit submitted by AT&T, arguing that the price squeeze theory articulated in that affidavit rests on several assumptions, including the margins in the U.S. market, whether competing carriers will match price reductions, and the degree of

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388 *Id.* at 6-7. Cable and Wireless also opposes the settlement rate benchmark condition for the provision of facilities-based and private line services to affiliated markets we adopted in the *Benchmarks Order*. But, as discussed above, comments on the facilities-based condition adopted in the *Benchmarks Order* are outside the scope of this proceeding.

389 *See also* Telefónica Internacional October 28 *Ex Parte* at 4-5.

390 AT&T October 27 *Ex Parte* at 4; *see also* MCI November 17 *Ex Parte* at 2.

391 *See also* Telefónica Internacional October 28 *Ex Parte* at 4; Letter from F. Gordon Maxson to William F. Caton, Acting Secretary, FCC, IB Docket No. 97-142 (November 18, 1997) at 1 (GTE November 18 *Ex Parte*).

392 *Id.*

393 AT&T October 27 *Ex Parte* at 13 (this argument is contained in a surrebuttal by William Lehr contained in AT&T's *Ex Parte* filing).

394 *Id.* n.20.

demand elasticity in the U.S. market, that have not been substantiated.[395] It further argues that the Lehr Affidavit is not credible because it does not take into account the differences between the switched resale and facilities-based markets.[396] Cable and Wireless also argues that applying the settlement rate condition to switched resale services would violate the United States' GATS commitments, contravene the equal protection provisions of the Fifth Amendment, constitute an unlawful taking under the Fifth Amendment, and be inconsistent with the Commission's domestic policies.[397]

Discussion

191. In the *Benchmarks Order*, we concluded that we should condition authorizations to provide facilities-based switched or private line service to an affiliated market on compliance with the benchmark settlement rates. We concluded that this authorization condition is necessary to reduce the ability of carriers serving affiliated markets to execute a predatory price squeeze. We do not revisit those conclusions here. Nor do we address the comments filed in this proceeding on the authorization condition for facilities-based service to affiliated markets. Because we explicitly stated in the *Notice* that we would decide whether to adopt the conditions in the *Benchmarks* proceeding, comments on the condition filed in this proceeding are outside the scope of the issues raised in the *Notice*.[398] However, because the authorization condition is an important element of the new regulatory scheme we adopt in this *Order*, we describe the condition here.[399] We also address AT&T's request that we extend the facilities-based condition to cover the provision of resold switched services to affiliated markets. In our *Benchmarks Order*, we deferred consideration of AT&T's request to this proceeding.

a. Benchmark Condition for Facilities-Based Service to Affiliated Markets

192. The settlement rate benchmark condition we adopted in the *Benchmarks Order* is intended to reduce the ability of U.S.-licensed carriers to engage in a predatory price squeeze, *i.e.*, to

395 *Id.* at 11-15; *see also* Telefónica Internacional Reply at 15-20 (the assumptions underlying AT&T's model of price squeeze do not "hold true").

396 Cable and Wireless October 10 *Ex Parte* at 8.

397 *Id.* at 17-24; *see also* Telefónica Internacional October 28 *Ex Parte* at 6-7 (condition would be unconstitutional and would compromise key GATS principles).

398 KDD states that the Commission's "decision to issue apparently identical settlement rate proposals in two different proceedings is confusing." KDD Comments at 11. We specifically stated in the *Notice*, however, that the settlement rate benchmarks conditions would be considered in the *Benchmarks* proceeding. *Notice* ¶ 119.

399 We clarify that we do not address in this section the benchmarks condition for the provision of switched services over private lines adopted in the *Benchmarks Order*. That benchmarks condition is discussed *supra* in Section II.B.2.

price below the level of its imputed costs, when providing service to an affiliated foreign market.[400] Pursuant to the *Benchmarks Order*, we will condition an authorization to serve an affiliated market on the foreign carrier offering U.S.-licensed international carriers a settlement rate for the affiliated route at or below the relevant benchmark adopted in the *Benchmarks Order*.[401] Requiring that a carrier's settlement rates be at or below the relevant benchmark before its U.S. affiliate may provide facilities-based service to an affiliated market substantially reduces the above-cost settlement rates that could be used to execute a price squeeze. It does not, however, completely eliminate the ability of a carrier to execute a price squeeze because the settlement rate benchmarks we adopted in the *Benchmarks Order* are still above-cost. We therefore decided in the *Benchmarks Order* that we will take enforcement action if, after the U.S.-licensed carrier has commenced service to the affiliated market, we discover that the carrier has attempted to execute a predatory price squeeze or engaged in other anticompetitive behavior that distorts market performance. That action may include a requirement that the foreign affiliate reduce its settlement rate for the route to a level equal to or below the best practices rate we adopted in the *Benchmarks Order*, $0.08, or a revocation of the authorization of the carrier to serve the affiliated market. We adopted a rebuttable presumption in the *Benchmarks Order* that a carrier has distorted market performance if any of the carrier's tariffed collection rates on the affiliated route are less than the carrier's average variable costs on that route.

b. Consideration of Benchmark Condition for Switched Resale Service to Affiliated Markets

193. We now turn to the issue of whether to apply our benchmark condition to authorizations to provide switched resale service from the United States to an affiliated market, which we did not resolve in the *Benchmarks Order*. A switched reseller normally takes service from an underlying facilities-based carrier at a generally-available tariffed rate reflecting a volume discount, and then resells that service to end-user customers. The underlying facilities-based carrier is responsible for all settlement payments and receives all proportionate return traffic.

194. We decline to apply the settlement rate benchmark condition to switched resale providers. Our goal in this proceeding is to adopt a regulatory framework that is narrowly tailored to address identifiable harms to competition and consumers in the U.S. market. We, therefore, approach critically any request for conditions that would impose additional burdens on the manner in which companies could provide service to the U.S. market and thereby provide consumers with additional choices. We concluded in our *Benchmarks Order* that there exists a danger of anticompetitive effects resulting from the ability of a facilities-based U.S. affiliate of a foreign carrier to "price squeeze" its competitors because of its relationship with the foreign affiliate. We do not find that the same danger of anticompetitive effects results from a switched reseller's provision of service to an affiliated market.

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[400] For a discussion of the ability of a foreign affiliated facilities-based carrier to execute a predatory price squeeze, see *Benchmarks Order* ¶¶ 195-231.

[401] In the *Benchmarks Order*, we found that we have authority to establish and enforce settlement rate benchmarks under Sections 1, 2, 4(i), 201, 205, 214 and 303(r) of the Communications Act, 47 U.S.C. §§ 151, 152, 154(i), 201, 205, 214, 303(r).

We decline, therefore, to adopt AT&T's proposal that we apply the benchmarks condition to the provision of resold switched services.

195. We find that such a condition is unnecessary for two reasons. First, a switched reseller has substantially less incentive to engage in a predatory price squeeze strategy than a facilities-based carrier. Second, it is easier to detect a predatory price squeeze in the switched resale context than in the facilities-based context. Easier detection should deter switched resellers from attempting a predatory price squeeze and will allow the Commission or other authorities to take action in the event a carrier does attempt a predatory price squeeze. We explain each of these reasons in more detail below. We also believe the benefits to consumers of additional new entrants and existing switched resale providers in the U.S. market outweigh the minimal risk to competition from a possible predatory price squeeze or other anticompetitive behavior by a switched resale provider providing service to an affiliated market.

196. We also decline to apply the settlement rate benchmark conditions proposed by WorldCom and MCI. The conditions proposed by WorldCom and MCI would require that a switched reseller's foreign affiliate commit to abide by the transition schedules and proportional glide-path requirements set forth in the FCC's *Benchmarks Order*.[402] We decline to adopt WorldCom and MCI's proposed conditions for the same reason we do not apply the condition adopted in the *Benchmarks Order*: they are not necessary or appropriate to address a concern about anticompetitive behavior in the U.S. market. As discussed in more detail below, we conclude that the provision of switched resale services to affiliated markets does not raise the same competitive concerns as the provision of facilities-based service to affiliated markets. WorldCom and MCI state that allowing foreign carriers to enter the U.S. market without making a commitment to comply with the settlement rate benchmarks would undermine the *Benchmarks Order* by creating a disincentive for foreign carriers to negotiate lower accounting rates. The safeguards we adopt in this *Order* and the settlement rate benchmark conditions we adopted in the *Benchmarks Order* are designed to address competitive concerns in the U.S. market. Where conditions are not necessary to address such concerns, we do not believe they are appropriate. As we stated in the *Benchmarks Order*, we will take appropriate enforcement measures as may be necessary to ensure that U.S. carriers satisfy our benchmark requirements. Our action in this proceeding does not undermine our commitment to achieving compliance by U.S. carriers with our benchmarks.

197. We also find, contrary to AT&T's argument, that there is no evidence that affiliation status significantly exacerbates the potential for traffic distortions. At most, an affiliate relationship could facilitate arrangements that may result in traffic distortions. We thus conclude that the settlement rate benchmark condition would not be an appropriate safeguard against such potential traffic distortions. Nevertheless, to monitor whether switched resale entry into the U.S. market exacerbates the potential risk of traffic distortions, we will apply a quarterly traffic and revenue reporting requirement to switched resale carriers where they are affiliated with a foreign carrier that possesses sufficient market power in the foreign market to adversely affect competition in the U.S. market.

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[402] WorldCom November 18 *Ex Parte*; MCI November 18 *Ex Parte* at 1.

i. Incentive to Engage in a Price Squeeze Strategy

198. We address first our conclusion that a switched reseller lacks significant incentives to engage in a predatory price squeeze strategy. AT&T argues that a U.S.-licensed carrier providing switched resale services to an affiliated market has the same ability and incentive to execute a price squeeze against competitors in the U.S. market as a facilities-based carrier providing service to an affiliated market.[403] We agree with AT&T that a U.S.-licensed carrier providing switched resale services to an affiliated market has the ability to price its retail services below the level of its imputed costs. We disagree, however, with AT&T's contention that the threat of a predatory price squeeze is the same in the switched resale context as it is in the facilities-based context. For the reasons described below, we believe that a switched resale carrier has less of an incentive than a facilities-based carrier to attempt a price squeeze that aims to foreclose competition in the IMTS market on an affiliated route.

199. An integrated carrier may attempt a predatory price squeeze if it expects that it can subsequently raise price while foreclosing subsequent entry by new competitors. However, a switched reseller generally can neither force competitors to exit nor prevent subsequent entry. This is because a switched resale provider does not control the underlying international facilities over which it provides service.[404] The lack of control over facilities means that it would be impossible for a switched reseller to force all facilities-based carriers to cease serving a route permanently. Because existing facilities are sunk investments, it is implausible that they would be abandoned. If a facilities-based carrier were forced to exit as a result of the predatory strategy of a competing facilities-based carrier, the predating facilities-based carrier could take control of the exiting carrier's facilities. However, a switched reseller by definition cannot acquire facilities without itself becoming a facilities-based carrier subject to the benchmark condition.[405] Moreover, because a reseller must purchase wholesale service from a

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403 AT&T Comments at 31-32.

404 Even where a switched reseller has an affiliation or a common business interest with the underlying facilities-based carrier, the switched reseller's lack of control over the underlying facilities makes a predatory strategy highly unreliable. This is because if the switched reseller were successful in driving all other competitors out of the market, the underlying facilities-based carrier would have a strong incentive to break its alliance with the preying switched reseller and benefit from the lack of competition by raising the price of the wholesale service it provides to the preying switched reseller or by entering the retail market itself and charging a supra-competitive price. To the extent that a switched reseller's affiliation with a facilities-based carrier may create a significant potential for a price squeeze in an individual circumstance, we can impose the benchmarks condition, or some other condition, on that reseller's authorization. *See infra* ¶ 214 (noting that we reserve the right to impose additional conditions on individual authorizations, as necessary).

405 It is conceivable that a predatory price squeeze executed by a reseller might result in a more concentrated ownership of facilities, if, for example, a facilities-based carrier sells its facilities to the carrier that provides service to the predating reseller. To the extent the facilities-based carrier providing service to the predating reseller increases its market power in the wholesale market, however, it will have the incentive and ability to charge a higher wholesale price to the predator, thus increasing the

facilities-based carrier, there will always be at least one facilities-based carrier in the market from whom the reseller has to buy wholesale service. In such a circumstance, the underlying facilities-based carrier, not the reseller, is best positioned to benefit from the exclusion of competition. The underlying facilities-based carrier could either profitably raise the price of the wholesale service it sells to the preying switched reseller, or, if it had the capability to offer retail service, profitably enter or re-enter the retail market for that route.

200. The lack of control over facilities also means that it would be difficult for a switched reseller to impede resale entry. Resellers provide price discipline in the market because they can enter on short notice and with minimal financial risk. Unlike a facilities-based provider, a switched reseller is fully dependent upon an underlying facilities-based carrier that is under a legal obligation as a common carrier to provide wholesale service to any and all resellers on a nondiscriminatory basis. Thus, a reseller that attempts to execute a predatory price squeeze would be unable to prevent new switched resale entrants from easily entering the market and defeating the predatory strategy. Further, the lack of control over facilities would make it substantially more difficult for a switched reseller to deter future entry by both facilities-based carriers and resellers. A predating switched reseller is unlikely to be able to command sufficient network capacity to credibly convince potential new entrants that they will be driven from the market by predatory pricing. Given that a switched reseller generally can neither force competitors to exit nor prevent subsequent entry, we conclude that a switched reseller has less of an incentive than a facilities-based carrier to attempt a price squeeze that aims to foreclose competition in the IMTS market on an affiliated route.

201. AT&T argues that a switched reseller, as well as a facilities-based carrier, would have the incentive and ability to engage in a price squeeze without subsequently raising calling prices. It argues that a U.S.-licensed carrier would benefit from permanently pricing below its imputed costs because such a pricing strategy would generate additional settlements profits to its foreign affiliate by stimulating demand from the U.S. market to the affiliated market.[406] These additional settlements profits, according to AT&T, would more than offset a carrier's losses from engaging in below-cost pricing. We are not convinced by AT&T's argument. As an initial matter, it is not clear that the pricing behavior AT&T describes would harm consumers because, under the scenario AT&T describes, calling prices would remain low permanently. Moreover, even if the price squeeze strategy AT&T describes would harm consumers, we are not convinced that the strategy would be successful for the predating carrier.

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predator's cost and making recoupment less likely.

[406] AT&T Comments at 30. AT&T also states that "while the desire to maximize the settlement subsidy provides an important rationale for engaging in anticompetitive behavior," it is not the only reason to apply the benchmarks condition to switched resellers. AT&T states that the condition would also "reduce [a] foreign carrier's ability to engage in other sorts of anticompetitive activity." AT&T October 27 *Ex Parte* at 10. AT&T does not, however, explain the connection between above-cost settlement rates and the ability to engage in other types of anticompetitive behavior. Moreover, the competitive safeguards we adopt in this *Order* address the ability of a foreign carrier to leverage market power into the U.S. market.

202. AT&T's argument is based on the assumption, contained in the Lehr Affidavit, that U.S. competitors would match the U.S.-licensed carrier's price reductions, *i.e.*, price below the level of their costs, and accept losses indefinitely on the affiliated route in order to remain viable as full service providers.[407] The premise that carriers will offer service at below-cost prices in the long-term is a highly unusual economic theory and we are not convinced by AT&T's justification. Moreover, competing carriers could defeat the predating carrier's strategy by refusing to follow the price reductions. If competing carriers did not follow the price reductions, the predating carrier would take a greater loss because the predating carrier would be selling more minutes at a below-cost level due to the demand that migrates from competing carriers to the predating carrier. Given these considerations, the likely effect of a price squeeze strategy would be to enable the predating carrier to gain market share in the United States, but only at the expense of reduced total profits for the integrated carrier as long as the reduced prices remain in effect.

203. In summary, we conclude that the threat of a switched reseller attempting a predatory price squeeze is substantially less than the threat of a facilities-based carrier attempting a predatory price squeeze. Our conclusion is based on our finding that a switched reseller has less incentive to engage in a predatory price squeeze that aims to foreclose competition in the IMTS market on an affiliated route. Moreover, we are not convinced by AT&T's argument that a carrier would have the incentive and ability to engage in a price squeeze without foreclosing competition and subsequently raising prices. To the contrary, we find that the price squeeze strategy described by AT&T is unlikely to be profitable for either a facilities-based carrier or a switched reseller.

ii. Detection of Price Squeeze Strategy

204. We further find that we need not apply the benchmark condition for service to affiliated markets to the provision of switched services because detection of an attempted predatory price squeeze scheme by a switched reseller is easier than by a facilities-based carrier. As Cable and Wireless notes, a significant portion of a switched resale provider's costs, the wholesale rate at which it takes service from the underlying facilities-based carrier, is known or readily identifiable by the Commission and the underlying facilities-based carrier. As a result, the Commission, antitrust authorities, and, potentially, the underlying facilities-based carrier, will be able to detect if a switched reseller attempts to price below the level of the wholesale rate at which it takes service. This is not the case for facilities-based carriers, because the Commission and carriers do not have precise information on the underlying transmission costs of a facilities-based carrier. While a switched reseller has some additional variable costs, primarily marketing costs, by far the bulk of its variable costs is

[407] Cable and Wireless notes that the Lehr Affidavit relies on several unsubstantiated assumptions concerning the margins in the U.S. market, whether competing carriers will match price reductions, and the degree of demand elasticity in the U.S. market. Cable and Wireless October 10 *Ex Parte* at 11-15. We agree with Cable and Wireless that many of the assumptions in the Lehr Affidavit are unsubstantiated. We believe the most important of these assumptions to AT&T's argument, and the one that is most suspect, is that competing carriers will follow the price reductions of a preying switched reseller indefinitely.

the wholesale rate at which it takes service. Thus, any price for switched resale service that is below the level of the wholesale tariff at which the switched reseller takes service would be suspect.

205. We note that MCI argues that the Commission should require switched resellers with foreign affiliates that have market power to file with the Commission "copies of all contracts, agreements and arrangements, whether written or oral, with any other carrier relating to services and traffic on all routes."[408] MCI argues that such a condition is necessary to provide an opportunity to monitor the reseller's costs to ensure that it is not acting in an anticompetitive manner.[409] We decline to adopt this commitment as a general requirement applied to all switched resellers that are affiliated with a foreign carrier with market power. While obtaining a switched reseller's costs for underlying services may be cumbersome in some cases, the Commission can nonetheless require carriers to provide the information necessary to calculate the price at which they take service. Moreover, as MCI notes, there is an active spot market in wholesale minutes.[410] The existence of a spot market means that market participants have up-to-date information on pricing trends. It does not, contrary to MCI's argument, make it more difficult to detect a price squeeze strategy by a switched reseller.[411] These factors make detection of an attempted price squeeze scheme by a switched reseller easier than for a facilities-based carrier. Easier detection for switched resellers should act as a deterrent to carriers contemplating a predatory price squeeze. It would also enable the Commission to monitor the market and take action, including imposing additional authorization conditions, to prevent anticompetitive behavior if necessary.

206. We also decline to adopt the proposal of Telefónica Internacional, offered as an alternative to the benchmark condition, to apply a requirement that foreign-affiliated switched resellers agree to refrain from offering service at an average price that is below the average price at which they obtain those services from underlying facilities-based carriers.[412] Telefónica Internacional notes that in the *TSC Order*, the International Bureau accepted a similar voluntary commitment by the resale carrier Telmex/Sprint Communications, L.L.C. (TSC).[413] As we discussed above, we find that switched resellers have significantly less incentive to engage in a price squeeze. We therefore decline to adopt

[408] MCI November 18 *Ex Parte*.

[409] *See id.*; *see also* MCI November 17 *Ex Parte* at 2. AT&T contends that there are certain factors that make monitoring of wholesale prices difficult, including the fact that resellers typically purchase by private contract under complex arrangements and that carriers purchase resale services from numerous carriers frequently at "spot" prices. AT&T October 27 *Ex Parte* at 4.

[410] MCI November 17 *Ex Parte* at 2.

[411] *Id.*

[412] Letter from Alfred Mamlet and Colleen Sechrist to William F. Caton, Acting Secretary, FCC (November 13, 1997) at 2 (Telefónica Internacional November 13 *Ex Parte*).

[413] *See Telmex/Sprint Communications, L.L.C.*, File No. I-T-C-97-127, ¶¶ 62, 102 (rel. Oct. 30, 1997)(*TSC Order*).

this commitment as a general requirement applied to all foreign-affiliated switched resellers. We note, however, that we have the authority to require individual resellers to comply with such a requirement if we deem it is warranted in a particular circumstance.

iii. Traffic Distortions

207. AT&T argues that entry into the U.S. market by dominant foreign carriers can exacerbate gaming of the settlements process on affiliated routes and that this concern justifies application of the benchmarks condition to both facilities-based and switched resale providers. Specifically, AT&T argues that a foreign-affiliated carrier providing service in the U.S. market could game the settlement system by distorting traffic flows in two primary ways: (i) by participating in a call turnaround scheme to turn the U.S.-inbound calls of its foreign affiliate into U.S.-outbound calls; and (ii) by re-originating from the United States calls from a third country.[414] AT&T states that the first of these traffic distortion schemes, call turnaround, would benefit the foreign carrier by generating additional settlement revenues and benefit the underlying U.S. facilities-based carrier involved in the scheme by increasing its share of return traffic at the expense of other competing carriers in the U.S. market. According to AT&T, the second of these traffic distortion schemes, re-origination, would benefit a U.S. facilities-based carrier by increasing its share of return traffic at the expense of other competing carriers in the U.S. market. AT&T states that these traffic distortion schemes would harm consumers in the same way that one-way bypass of the settlements system would -- by increasing U.S. net settlement payments. This increase would, according to AT&T, increase U.S. carriers' marginal costs, which in turn would put upward pressure on calling prices.[415]

208. We agree that foreign carriers have incentives to distort traffic flows in ways that would increase settlement payments from U.S. facilities-based carriers and that, in turn, U.S. facilities-based carriers have an incentive to increase their share of proportionate return traffic. In addition, switched resellers have an incentive to engage in call turnaround because it would generate additional revenues from the sale of U.S.-outbound minutes to the foreign carrier. However, it is not clear that these practices are likely to harm competition and consumers in the U.S. market. U.S. carriers currently engage in call turn-around and re-origination practices. As AT&T notes, these practices can have pro-competitive benefits, such as arbitraging differences in retail prices between foreign countries and the U.S. or differences in settlement rates that a foreign country charges for terminating traffic from various countries.[416]

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[414] AT&T October 27 *Ex Parte* at 18-20; AT&T November 18 *Ex Parte* at 9-13. AT&T states that a carrier could achieve the same result through fraudulent reporting of U.S.-outbound minutes. AT&T November 18 *Ex Parte* at 9.

[415] *Id.* at 10-11.

[416] AT&T November 18 *Ex Parte* at 6. The traffic distortions that AT&T describes could in some circumstances potentially harm U.S. consumers if they have the effect of increasing U.S. net settlement payments. However, this effect, to the extent it occurs, could also result from the types of call turn-around and re-origination practices that have pro-competitive benefits, and to which AT&T does not object.

209. Even if the traffic distortions described by AT&T would harm competition and consumers in the U.S., we are not convinced that the potential for such traffic distortions would be exacerbated by foreign entry into the United States, as AT&T argues. To the contrary, the incentives and, to a large extent, the ability to engage in the traffic distortions described by AT&T exist regardless of whether there is an affiliate relationship between a foreign and U.S. carrier. With respect to AT&T's argument about call turn-around practices, it may be somewhat easier for a foreign carrier to engage in call turn-around if it has a U.S. affiliate because the foreign carrier would not have to find a separate carrier in the U.S. market through which to route traffic. Given that any U.S. carrier would increase revenues by participating with a foreign carrier in call turnaround, however, it should not be difficult for a foreign carrier to find an unaffiliated carrier in the United States through which to route traffic.[417] Indeed, AT&T states that because "there are competing U.S. carriers vying to provide wholesale transport capacity, a foreign carrier will find no shortage of willing partners."[418] With respect to AT&T's arguments about re-origination of third country traffic, U.S. facilities-based carriers do not need a foreign affiliate to engage in this practice. As AT&T notes, U.S. facilities-based carriers currently re-originate traffic from third countries to arbitrage differences in accounting rates.[419] They do this despite the fact that foreign carriers generally do not approve of re-origination. We thus believe that affiliation is unlikely to increase substantially a foreign carrier's incentive or ability to engage in traffic manipulation.

210. AT&T states generally that "affiliation can help to align interests" of the parties engaged in the traffic distortion scheme but does not provide any evidence that affiliation status increases the incentive to engage in traffic distortions or makes it significantly easier to engage in such distortions.[420] The only concrete benefit of alliance cited by AT&T is that "any offsetting financial transfers that may be necessary to compensate one party or another could be undertaken in a less detectable manner — and perhaps in a more lawful manner as well — through an affiliate than otherwise."[421] It is not clear, however, that "offsetting financial transfers" would be necessary in most cases, as U.S. carriers would gain revenues from participating in the schemes described by AT&T. As an example of an "offsetting transfer," AT&T states that additional compensation would be necessary if the wholesale price paid by a foreign carrier to a U.S. facilities-based carrier is not sufficient to compensate the facilities-based carrier for the cost of providing U.S.-outbound service for call turn-around practices. AT&T states that this could occur if the additional outbound traffic that resulted from the call turn-around practices raised the facilities-based carriers' marginal cost of providing

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[417] *See* Letter from Leon Kestenbaum to Magalie R. Salas, Secretary, FCC, IB Docket 97-142 (November 17, 1997) at 2 (Sprint November 17 *Ex Parte*).

[418] *Id.* at 29.

[419] AT&T November 18 *Ex Parte* at 6, 20.

[420] *Id.* at 16.

[421] *Id.* at 30.

service.[422] While there may be cases where additional outbound-traffic raises a facilities-based carrier's marginal cost, the facilities-based carrier could be made whole simply by raising its wholesale prices to a compensatory level. Nonetheless, even if "offsetting financial transfers" were necessary in some instances, we believe that the traffic reporting requirements we adopt below will enable us to detect whether affiliated carriers are engaging in traffic distortion schemes on affiliated routes.

211. We find that concerns about potential traffic distortions are not directly related to affiliation status. Moreover, there is not sufficient evidence in the record to demonstrate that the potential traffic distortions AT&T describes are so likely to harm competition and consumers in the United States that applying the benchmarks condition is necessary. We accordingly conclude that adopting the condition proposed by AT&T or applying the benchmarks condition we adopted in the *Benchmarks Order* to the provision of switched resale services to an affiliated market would not be an appropriate safeguard against potential traffic distortions. Nonetheless, we adopt a reporting scheme to monitor traffic flows carefully to determine whether foreign carrier entry into the U.S. market could exacerbate the potential for anticompetitive traffic distortions. In Section V.C.2.b.(iv), *infra*, we adopt a quarterly traffic and revenue reporting requirement that will enable us to detect whether facilities-based carriers are engaging in traffic distortion schemes on routes where they are affiliated with foreign carriers that possess market power.[423] We adopt here a requirement that all switched resale providers file quarterly traffic and revenue reports pursuant to Section 43.61 on international routes where they are affiliated with a foreign carrier that possesses market power in a relevant market on the foreign end of the route and that collects settlement payments from U.S. carriers.[424] This reporting requirement should enable us to detect whether switched resellers are engaging in traffic distortion schemes on affiliated routes.[425]

212. We emphasize that we reserve the right to review and, if necessary, impose additional conditions as necessary on individual authorizations if we perceive that a carrier is attempting to engage in anticompetitive behavior.[426] If we find that a U.S.-licensed carrier, regardless of whether it is providing service to an affiliated market, is engaging in traffic distortion practices that harm

[422] AT&T November 18 *Ex Parte* at 17-18 (according to AT&T, the U.S. facilities-based carriers' marginal costs could increase as a result of call turn-around if its initial share of traffic was sufficiently large and the call turn-around scheme involved significant volumes of traffic).

[423] We note further that, under the *Benchmarks Order*, all carriers with a notable amount of international traffic must also file quarterly traffic and revenue reports. *See Benchmarks Order* ¶ 251; *see also infra* note 574.

[424] As noted above, the relevant markets on the foreign end of a U.S. international route generally include: international transport facilities or services, including cable landing station access and backhaul facilities; inter-city facilities or services; and local access facilities or services on the foreign end. *See supra* ¶ 145.

[425] *See* Sprint November 17 *Ex Parte* at 2.

[426] *See infra* ¶ 214.

competition and consumers in the U.S. market, we will take appropriate measures.[427] For example, in such a case, we could apply the benchmark condition to an individual switched reseller providing service to an affiliated market.

iv. Other Considerations

213. We are also concerned that applying the settlement rate benchmark condition to the provision of switched resale services to affiliated markets will substantially limit additional entry into the U.S. IMTS market. As AT&T and Cable and Wireless point out, resale entry may have advantages over facilities-based entry for some entrants. It is less expensive initially and less capital intensive, and can thus occur more rapidly than facilities-based entry.[428] Applying the settlement rate benchmark condition to switched resale services could effectively deter some carriers from entering the U.S. market on a resale basis and is not necessary, given our findings here.[429] We are also concerned, as Cable and Wireless points out, that extending the condition to switched resale services could effectively force existing competitors to exit the market, thereby further reducing competition and resulting in disruption to consumers.[430] We thus conclude that the benefits to consumers of additional new entrants and existing switched resale providers in the U.S. market outweigh the minimal risk to competition from the potential anticompetitive conduct discussed above.

214. We emphasize here that we will monitor the switched resale market carefully and if we find substantial evidence that carriers providing switched resale services to affiliated markets are engaging in anticompetitive behavior that causes harm to competition and consumers in the U.S. market, we may reconsider our decision not to apply the benchmark condition to the provision of switched resale services. We also reserve the right to impose additional conditions as necessary on individual authorizations if we perceive that a carrier is attempting to engage in anticompetitive behavior.

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[427] *See infra* Section V.D (discussing Commission's enforcement authority).

[428] AT&T Comments at 32; Cable and Wireless October 10 *Ex Parte* at 5 ("competition starts with resale; it allows carriers to enter the market and establish their brand presence with minimal financial risk").

[429] AT&T contends that a benchmarks condition would deter resale entry "only if the foreign carrier intends to exploit above-cost settlement rates." AT&T October 27 *Ex Parte* at 9 (Lehr surrebuttal). AT&T provides no support for this assumption that U.S.-licensed carriers will only serve affiliated markets in order to exploit the opportunity to engage in anticompetitive behavior.

[430] Cable and Wireless October 10 *Ex Parte* at 4-5.

2. Dominant Carrier Safeguards

a. Regulatory Framework

Background

215. Our regulations governing the U.S. international services market traditionally have distinguished between "dominant" and "non-dominant" carriers. We have classified carriers operating in the U.S. market, whether U.S.- or foreign-owned, as dominant in their provision of U.S. international services on particular routes in two circumstances: (1) where we have determined that a U.S. carrier can exercise market power on the U.S. end of a particular route;[431] and (2) where we have determined that a foreign carrier has market power on the foreign end of a particular route that can adversely affect competition in the U.S. international services market.[432] Carriers regulated as dominant on a particular route due to an affiliation with a carrier possessing market power on the foreign end of that route are subject to specific safeguards set forth in our rules.[433] These safeguards differ significantly from the safeguards the Commission traditionally has imposed on U.S. carriers regulated as dominant due to market power on the U.S. end of a route because our domestic rules are "generally designed to prevent a carrier from raising its prices by restricting its output rather than to prevent a carrier from raising its prices by raising its rivals' costs."[434] Our focus here is to adopt an

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[431] *See generally International Competitive Carrier Policies*, CC Docket No. 85-585, Report and Order, 102 FCC 2d 812 (1985), *recon. denied*, 60 RR 2d 1435 (1986); *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, FCC 97-142, ¶ 140 (rel. Apr. 18, 1997), *recon.* FCC 97-229 (rel. June 27, 1997) (*LEC Regulatory Treatment Order*).

[432] *See generally Regulation of International Common Carrier Services*, Report and Order, 7 FCC Rcd 7331, 7334 ¶ 19 (1992) (*International Services*); *see also Foreign Carrier Entry Order*, 11 FCC Rcd at 3917 ¶ 116. For a definition of market power and relevant input markets, see *supra* ¶¶ 144-145.

[433] Pursuant to our existing rules, a foreign-affiliated carrier regulated as dominant on a particular route is required to: "(1) file international service tariffs on 14-days notice without cost support; (2) maintain complete records of the provisioning and maintenance of basic network facilities and services procured from its foreign carrier affiliate . . . ; (3) obtain Commission approval pursuant to § 63.18 before adding or discontinuing circuits; and (4) file quarterly reports of revenue, number of messages, and number of minutes of both originating and terminating traffic . . . ." 47 C.F.R. § 63.10(c).

[434] *LEC Regulatory Treatment Order* ¶ 85. The rules we adopt here do not affect those regulations associated with dominant carrier classification due to the market power of a U.S. carrier on the U.S. end of a route. These domestic regulations include rate of return or price cap regulation to ensure that rates are just and reasonable, *see* 47 C.F.R. § 61.41(a)(1), and more stringent requirements pursuant to Section 214 to prevent investment in unnecessary new plant and to bar service discontinuances in areas served by a single carrier. *See generally LEC Regulatory Treatment Order* ¶¶ 85-86; *Motion of AT&T Corp. to Be Declared Non-Dominant for International Services*, Order, FCC 96-209, ¶¶ 26-28 (May 14, 1996), *recon. pending*; *Petition of GTE Hawaiian Telephone Co., Inc. for Reclassification as a Non-*

effective regulatory scheme to address the risk of anticompetitive behavior by U.S. carriers affiliated with carriers that have market power on the foreign end of a U.S. international route.

216. We tentatively concluded in the *Notice* that the general obligations imposed on all U.S. international carriers[435] permit us to scale back our current dominant carrier safeguards "without compromising in any meaningful way our ability to monitor and prevent anticompetitive conduct."[436] We therefore proposed a set of basic dominant carrier safeguards that would apply to foreign-affiliated carriers if the foreign affiliate faces international facilities-based competition. These safeguards would replace the fourteen-day advance notice requirement for international service tariffs with a one-day notice period and a presumption of lawfulness. We also proposed to substitute a quarterly notification of circuit additions and discontinuances in place of the requirement that dominant foreign-affiliated

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Dominant IMTS Carrier, Order, DA 96-1748, ¶ 8 (Int'l Bur. Oct. 22, 1996); *but see Implementation of Section 402(b)(2)(A) of the Telecommunications Act of 1996*, CC Docket No. 97-11, Notice of Proposed Rulemaking, FCC 97-6 (rel. Jan. 13, 1997). Given the restrictions and safeguards we impose on the Bell operating companies (BOCs) and independent local exchange carriers (LECs), we concluded in the *LEC Regulatory Treatment Order* that these carriers will not be able to use, or leverage, their market power in the local exchange or exchange access markets to such an extent that they would have the ability, upon entry or soon thereafter, to raise the price of interexchange services by restricting their own output. *See, e.g., id.* ¶¶ 206-213. As a result, we concluded that these carriers' market power in the local exchange and exchange access markets did not warrant imposing traditional dominant carrier safeguards on their provision of in-region and out-of-region domestic and international long distance services. *See id.* ¶¶ 6-8; *NYNEX Long Distance Co. et al., GTE Telecom Incorporated, Application for Authority Pursuant to Section 214 of the Communications Act of 1934, as amended, to Provide International Service from Certain Parts of the United States to International Points through Facilities-based and Resale Services*, Memorandum Opinion and Order, DA 97-1662, File Nos. ITC-96-125, ITC-95-443, *et al.*, ¶ 12 (Int'l Bur. rel. Aug. 4, 1997). We concluded that the restrictions and safeguards that apply to the BOCs and independent LECs serve to limit their ability to disadvantage their interexchange rivals' provision of service. *See LEC Regulatory Treatment Order* ¶¶ 206-213. We noted in the *LEC Regulatory Treatment Order* that the question we examine here, whether any U.S. carrier should be regulated as dominant in the provision of international service because of the market power of an affiliated foreign carrier in a foreign destination market, is a separate issue. *See id.* ¶ 8 n.22.

[435] *See* 47 U.S.C. §§ 201–203; 47 C.F.R. § 43.51(a)–(d) (requiring common carriers engaged in foreign communications to file with the Commission certain contracts, agreements, and other arrangements); 47 C.F.R. § 43.51(e) (International Settlements Policy); 47 C.F.R. § 43.61 (requiring common carriers engaged in the provision of international telecommunications services between the United States and foreign destinations to file reports containing annual traffic and revenue data); 47 C.F.R. § 43.82 (requiring facilities-based carriers engaged in the provision of international services to file annual international circuit status reports); 47 C.F.R. § 63.14 (prohibiting U.S. carriers authorized to provide international communications services from agreeing to accept special concessions directly or indirectly from any foreign carrier or administration with respect to traffic or revenue flows between the United States and any foreign country for which the U.S. carrier is authorized to provide service); 47 C.F.R. § 63.15 (requiring private line resellers to file annual circuit addition reports).

[436] *Notice* ¶ 83.

carriers obtain prior approval before adding or discontinuing circuits on the dominant route. We proposed to retain the requirements that dominant carriers file quarterly traffic and revenue reports and maintain provisioning and maintenance records for services on their affiliated route.[437]

217. We also proposed to adopt a second dominant carrier category for those U.S. carriers affiliated with a foreign carrier that has market power in a relevant market and does not face competition from multiple international facilities-based competitors.[438] In addition to the basic safeguards identified above, we proposed to retain the existing prior approval requirement for circuit additions and discontinuances, require the filing of quarterly summaries of provisioning and maintenance records and quarterly circuit status reports, and ban exclusive arrangements involving joint marketing, customer steering, or the use of foreign market telephone customer information.[439] Finally, we requested comment on whether a U.S. carrier and its foreign affiliate should be subject to some level of structural separation.[440]

Positions of the Parties

218. Commenters are divided over our dominant carrier regulatory framework. Some commenters claim that it is unnecessary to apply any dominant carrier safeguards to U.S. carriers affiliated with foreign carriers that possess market power in a relevant market.[441] A number of

[437] *See id.* ¶¶ 92-103.

[438] *See id.* ¶¶ 104-110.

[439] *See id.*

[440] *See id.* ¶¶ 111-113.

[441] *See, e.g.*, DT Comments at 22-31 (arguing that other countries are not imposing safeguards, that there is no evidence that foreign-affiliated carriers have engaged in anticompetitive conduct in the past, that the WTO Basic Telecom Agreement eliminates any theoretical incentive or ability for foreign carriers to engage in such behavior, that other Commission rules restrain the leveraging of foreign market power into the U.S. market, and that at a minimum, the Commission should dispense with all dominant carrier safeguards for U.S. affiliates of carriers from WTO Member countries where the settlement rate is at or below the benchmark); C&W Comments at 4-5 (arguing that there is no evidence that foreign-affiliated carriers have engaged in anticompetitive conduct in the past and that such behavior is unlikely); Telia NA Reply Comments at 4, 10-11(arguing that the WTO Basic Telecom Agreement eliminates any theoretical incentive or ability for foreign carriers to engage in anticompetitive behavior, that an increased number of competitors and facilities reduces the potential for anticompetitive behavior, that the globalization of the telecommunications market decreases the significance of market power, that foreign-affiliated carriers are relatively small, and that local exchange carriers in the U.S. market are regulated as non-dominant in the interexchange market); GTE Comments at 4, 18 (arguing that dominant carrier safeguards are unnecessary because other Commission rules restrain the leveraging of foreign market power into the U.S. market and that the Commission should adopt a presumption that dominant carrier regulation is unnecessary for U.S. affiliates of carriers from WTO Member countries).

commenters contend that, rather than adopting the dominant carrier safeguards, the Commission should impose sanctions where it finds evidence of anticompetitive behavior.[442]

219. Several commenters perceive the need to classify U.S.-licensed carriers as dominant on routes where they are affiliated with a carrier that possesses market power on the foreign end. Several of these commenters strongly support the proposal to remove unnecessary regulations on U.S. carriers that are affiliated with foreign carriers that possess market power.[443] Some commenters support dominant carrier safeguards but oppose the two-tier proposal.[444] Other commenters support our proposal to adopt a dominant carrier regulatory framework consisting of basic and supplemental safeguards.[445] WorldCom supports the safeguards but argues that the Commission should apply varying levels of safeguards on a case-by-case basis.[446] Finally, New T&T Hong Kong argues that the basic safeguards are not sufficient to prevent harm to competition and urges the Commission to impose the supplemental safeguards on all U.S. affiliates of foreign carriers that possess market power on the foreign end of a U.S. international route.[447]

220. In addition, some commenters assert that the affiliation standard that serves as a threshold for applying dominant carrier safeguards must be clarified.[448] Several commenters also express support for our proposal to continue the existing policy of applying dominant carrier regulation to a U.S. carrier where a co-marketing or other non-equity arrangement with a foreign carrier that has

[442] *See* BTNA Comments at 3-4; GTE Reply Comments at 29; C&W Reply Comments at 9; NTT Reply Comments at 3.

[443] *See, e.g.*, European Commission Comments at 5; Sprint Comments at 20.

[444] The European Commission, for example, notes that the supplemental safeguards would be "over-regulation" because carriers that have market power in the European Commission home market already would be subject to prescriptive obligations against anticompetitive practices through nondiscriminatory and cost-based interconnection. *See* European Commission Comments at 6; *see also* Embassy of Japan Comments at 3 (asserting that supplemental safeguards should not be applied to U.S. carriers affiliated with foreign carriers from WTO Member countries).

[445] *See, e.g.*, MCI Comments at 8 (stating that "when no meaningful ability to compete exists, abuse of monopoly power is such a significant risk that the Commission should apply more stringent safeguards"); Sprint Comments at 20 (supporting the two-tier approach and arguing that supplemental safeguards should be imposed until the foreign affiliate faces international facilities-based competition "in some significant way"); AT&T Comments at 49-50 (supporting the overall approach but recommending that the Commission broaden the applicability of the supplemental tier and strengthen both the basic and supplemental safeguards); FaciliCom Comments at 9-10 (expressing general support for the proposal).

[446] *See* WorldCom Comments at 11; *see also* Sprint Comments at 22.

[447] *See* New T&T Hong Kong Comments at 1, 4.

[448] *See* Sprint Comments at 19; DT Comments at 27.